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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1638

BETTY L. GOLD, on Behalf of the SUSQUEHANNA CORPORATION, *Petitioner*,

v.

ARCH C. SCURLOCK and GLEN L. SLOANE, *Respondents*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR RESPONDENT SCURLOCK IN OPPOSITION

Respondent Arch C. Scurlock (Scurlock) submits this brief in opposition to a petition for a writ of certiorari to review a decision by the Court of Appeals for the Fourth Circuit holding Scurlock not liable under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) for profits realized on a sale

of securities, *Gold* v. *Sloan et al.*, 486 F.2d 340 (4th Cir. 1973).

QUESTION PRESENTED

Whether the Court of Appeals correctly applied this Court's recent decision in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), when it ruled that Scurlock, a "statutory insider," did not make a "purchase" within Section 16(b) in exchanging his stock for stock of the surviving company in a merger and thus was not liable for any profit on a sale of the new stock within six months thereafter because he had no opportunity for abuse of inside information in connection with the merger.

PROCEEDINGS BELOW

This case is one of five actions brought by petitioner under Section 16(b) in the United States District Court for the Eastern District of Virginia. The District Court found Section 16(b) liability in four of the five actions, entering a judgment against Scurlock for $736,519 plus prejudgment interest of $167,331. On appeal of four of the actions,[1] the Court of Appeals after briefing and argument entered an order May 22, 1972 postponing its decision pending action by this Court in *Kern County* and issued its decision October 19, 1973 after receiving further briefs from the parties on the effect of the *Kern County* decision. In an opinion by Circuit Judge Russell, concurred in by Senior Circuit Judge Boreman, the Court of Appeals reversed the judgments against respondents Scurlock and Glen L.

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[1] One defendant held liable did not appeal; petitioner appealed from a judgment in favor of another defendant, Keith E. Rumbel.

Sloane. As to the other two defendants, the judgment holding Keith E. Rumbel not liable was affirmed and the judgment holding Arthur W. Sloan (Sloan) liable was affirmed except for an award of prejudgment interest which was vacated. Circuit Judge Winter filed a separate opinion, concurring in the affirmance of the judgments in favor of Rumbel and against Sloan, and dissenting from reversal of the judgments against Scurlock and Glen L. Sloane. Petitioner's application for a rehearing en banc was denied.

COUNTER-STATEMENT OF FACTS

The petition omits reference to numerous uncontested facts demonstrating Scurlock's outsider status in relation to the merger of Atlantic Research Corporation (ARC) into The Susquehanna Corporation (Susquehanna) and his lack of opportunity for speculative abuse in connection with the merger. Such facts, as set forth by the Court of Appeals (see Pet. App. B. pp. 8b-22b), may be summarized as follows:

In 1949 Scurlock and Sloan founded ARC and until November, 1962 Scurlock was its president and chief executive officer. In 1962 Scurlock was removed from these positions and given the title of chairman of the board, and the ARC board created, and elected Sloan to, the position of the chief executive officer, declaring the office of president vacant. In 1965 Scurlock organized a proxy fight in an effort to replace Sloan as chief executive officer. However, at the 1965 annual meeting Sloan and his management slate received the vote of approximately two-thirds of the stock voting and took undisputed control of ARC. Scurlock retained membership on the board only by virtue of cumulative voting and from that point on was "simply

a disaffected stockholder and powerless director, tolerated but not welcomed by the management" (Pet. App. B, p. 8b). Subsequent management proxy statements pointed out that Scurlock was not included in the management slate. From 1965 on Scurlock was in frequent disagreement and contention with management and, in fact, was engaged in a stockholder suit against ARC, seeking to restrain it from acquiring another corporation, on the eve of the ARC board approval of the merger with Susquehanna.

Beginning in July, 1967 several corporations became interested in acquiring ARC by merger, and negotiations began with a number of such merger prospects, including Susquehanna. All merger negotiations with Susquehanna were conducted on behalf of ARC —at either the ARC offices or the offices of company counsel—exclusively by Sloan as ARC's chief executive officer and chairman of its board, Rice, its president, and Crowley, its secretary. Scurlock was not privy to any of these negotiations.

During July, 1967, ARC stockholders were advised of merger negotiations with Susquehanna and three other corporations by means of a mailed supplement to the management proxy statement for the July 28 annual stockholders' meeting, a press release summarizing such negotiations, and a further press release announcing the rejection of one offer and the submission of new offers by all four merger prospects, including, in Susquehanna's case, a dollar figure on the securities being offered in exchange for the ARC stock. By letter dated August 1 the investment banking firm of Goldman, Sachs & Co. recommended that the offer of Susquehanna be accepted. This letter

was distributed to the directors by Sloan at the directors' meeting on August 2. When the directors' meeting began, there was considerable disagreement over which of the several offers to accept. The merger was finally approved by a four-to-three vote of the directors, Scurlock voting in favor of the merger. As soon as the directors had acted, a public announcement was made.

On October 26 a joint ARC-Susquehanna proxy statement covering the material aspects of the merger was mailed to shareholders of both corporations in connection with special shareholders' meetings called for November 27 to vote on the merger. On that date the merger was approved and it became effective on December 4, 1967.

Pursuant to the terms of the merger Scurlock exchanged his 380,070 shares of ARC common stock for an equal number of Susquehanna preferred shares.[2] At the time of the merger Scurlock became one of the eleven directors of Susquehanna. Between December 20, 1967 and January 17, 1968, Scurlock sold 36,000 of his Susquehanna preferred shares.[3] Petitioner seeks to have Scurlock held liable under Section 16(b) for such sales. Prior to the sales Scurlock did not serve on any committee of the board, hold any other position with Susquehanna, or take an active role in any phase of its management other than to discharge his normal duties as a director.

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[2] Scurlock had owned all of the shares exchanged for five years or longer (Joint Appendix 576).

[3] The shares were sold pursuant to a registration statement filed with the Commission by Susquehanna, as issuer, under the Securities Act of 1933 (Joint Appendix 478).

REASONS FOR DENYING THE WRIT

Contrary to Petitioner's contention, the decision of the Court of Appeals does not conflict with the decisions of this Court, nor does it present any question of importance warranting review. With care and discrimination, the Court of Appeals correctly applied to the particular facts presented here the principles announced by this Court last term in *Kern County*.

I. The Court of Appeals correctly applied the principles of this Court's decision in Kern County to the facts relating to Scurlock.

Section 16(b) provides that any officer, director, or beneficial owner of more than 10% of the registered equity securities of a company (statutory insider) shall be liable to the company for any profits realized from any purchase and sale or sale and purchase of such securities occurring within a period of six months. The purpose of the provision, as stated in its opening sentence, is to prevent "the unfair use of information which may have been obtained by [the statutory insider] by reason of his relationship to the issuer . . . ." 15 U.S.C. § 78p(b).

In *Kern County* this Court stated that "[a]lthough traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of § 16(b), the courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions" such as mergers. The Court noted that in cases involving unorthodox transactions "the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information

—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits." The Court also observed that "the prevailing view is to apply the statute only when its application would serve its goals" and, in endorsing the "possibility of abuse" approach, reaffirmed its statement in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, at 424 n. 4 (1972), that "[i]n interpreting the terms 'purchase' and 'sale,' courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse." 411 U.S. at 593, 594-595.

In applying the possibility of abuse test to the facts in *Kern County,* the Court held that defendant Occidental, which became a more than 10% beneficial owner of stock in a target company through a tender offer, had not engaged in a "sale" within Section 16(b) when it exchanged its stock for new stock in the company which acquired the target company in a "defensive merger." In holding that the merger should not be deemed a "sale," the Court concluded that "the involuntary nature of Occidental's exchange, when coupled with absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one," 411 U.S. at 600.

Accepting the issue as stated in *Kern County* to be not whether there was "actual abuse of insider information" or "intent to profit on the basis of such information" but whether a defendant "had or was likely to have access to inside information, * * * so as to afford it [or him] an opportunity to reap speculative, short-swing profits" from the unorthodox tranaction (Pet. App. B 6b-7b, 411 U.S. at 595, 596), the

Court of Appeals correctly held that Scurlock, as an outside director without access to inside information, was in a position similar to Occidental in *Kern County:*

> "... Scurlock was not, as we have seen, in control of, or a participant in, the merger negotiations. While a nominal director of ARC he was as removed from the actual negotiations between ARC and Susquehanna *and was as much of an outsider looking on as was Occidental in Kern County.* He did know Susquehanna was interested in a merger with ARC but, until the notice that the 'management' gave the stockholders on July 11, he was as ignorant of the actual terms offered by Susquehanna as every other stockholder, despite the fact that he was a nominal director, albeit an unwelcome one. When the notice of July 11 gave him substantial information on Susquehanna's offer, it gave all other stockholders the identical information. *He acquired no potential for any abuse of insider information.* Morever, until the directors' meeting on August 2 he had no prior understanding or conferences with other directors, so far as the record shows, and he had no more reason to know whether the offer of Susquehanna would be accepted or rejected than any other stockholder .... It is true Scurlock voted for the merger but so for all practical purposes did Occidental in *Kern County.* In any event, Scurlock certainly did not have independent control over the merger's outcome; he had no more control than the other three directors who voted for its approval. More important, Scurlock possessed no knowledge that might have helped him speculate in Susquehanna's stock. *The point is that at no time did Scurlock have an opportunity to exploit any insider information.* He was never favored by Sloan over any other stockholder in information on the proposed merger." (Emphasis added.) (Pet. App. B 11b-13b)

In contrast, the Court of Appeals held that, unlike any other defendant, Sloan by reason of his position as chief executive officer in charge of the merger negotiations acquired inside information affording him a possibility of speculative abuse:

> "... Sloan possessed specific financial information concerning ARC and Susquehanna between the date of the August directors' meeting of ARC and the distribution of the proxy statement in October; Sloan, and no other defendant, had knowledge of certain inside information that would have helped him to predict the future performance of Susquehanna stock; such knowledge is the source of his 'possibility of speculative abuse.'" (Pet. App. B 26b)

Petitioner does not directly challenge the correctness of the conclusion of the Court of Appeals that Scurlock at no time had any opportunity to exploit inside information relating to the merger. Instead she seeks to overcome that determination by two contentions, both ill-founded.

First, petitioner erroneously asserts that the Court of Appeals made it a condition to finding Scurlock liable under Section 16(b) that he be shown to have possessed actual inside information enabling him to engage in speculative trading in Susquehanna shares. From the Court of Appeals' detailed description of Scurlock's outsider status in relation to the merger, it is apparent that the court found nothing in the record to indicate that Scurlock either had or was likely to have access to inside information prior to the merger which would help him to speculate in the stock of Susquehanna. Accordingly, the rule of *Kern County* required a holding that, absent a possibility of abuse

of inside information, Scurlock was not liable under Section 16(b) as a result of his participation in the merger. The finding of the Court of Appeals that Sloan in contrast possessed inside financial information relating to the merger not shared by any other defendant, thus making him liable does not in any way indicate that the standard of *Kern County* was misapplied in the case of Scurlock.

The Court of Appeals correctly concluded, in accordance with *Kern County*, that Scurlock was so situated that he had no possible access to inside information that could lead to speculative abuse and therefore had no Section 16(b) liability. Another recent decision recognizes the correctness of the ruling below regarding Scurlock, noting that in *Kern County* and in this case defendants (Occidental and Scurlock) were locked outside so effectively that neither could have acquired inside information forming the basis for Section 16(b) liability, see *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.* [Current Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,421 (N.D. Ill., January 30, 1974). It is also noteworthy that Judge Winter, dissenting on another ground (see pages 11-16, *infra*) agreed with the majority that Scurlock was "thoroughly immunized from access to inside information" since he "had no control over the merger negotiations," and "no access to information concerning the impending merger transaction," and stated that "[w]ere the possibility of speculative abuse test to be applied solely to events prior to the effective date of the merger, [he] would not quarrel too strenuously with the majority that Scurlock should not be held accountable for short-swing profits under § 16(b)." (Pet. App. B 35b-36b)

Second, petitioner argues that, because the merger gave rise to a possibility of abuse on the part of Sloan, the merger must be considered to involve a purchase under Section 16(b) for all directors, including Scurlock, irrespective of their knowledge or intent (Pet. 12). The contention that Scurlock and Sloan engaged in an identical transaction for purposes of Section 16(b) because they participated in the same merger is both simplistic and fallacious. Nothing in *Kern County* suggests that every statutory insider involved in a merger must automatically be deemed to have made a purchase if facts relating only to one insider require that result as to such insider. As noted, under *Kern County* no insider can be held liable under Section 16(b) for his participation in an unorthodox transaction such as a merger unless it appears that he "had or was likely to have access to inside information . . . so as to afford it [or him] an opportunity to reap speculative, short-swing profits" from the transaction, 411 U.S. at 596. The Court of Appeals correctly found that Scurlock had no such possible access to inside information concerning Susquehanna and therefore had no Section 16(b) liability.

II. The Court of Appeals, in determining whether Scurlock had an opportunity for speculative abuse that would require the merger to be treated as involving a "purchase" under Section 16(b), correctly took account only of events and circumstances up to the time of the merger.

The issue before the Court of Appeals was whether the merger involved a "purchase" by any defendant for purposes of Section 16(b). Under *Kern County* resolution of that issue required a determination whether the position or conduct of any defendant in

relation to the merger gave rise to a possibility of abuse that called for treating the merger as involving a purchase of stock in the surviving company by such defendant. The court below correctly held that the "merger is the cut-off date" for such determination, and that subsequent events are not relevant except as they may reveal the extent of prior knowledge leading to possible abuse (Pet. App. B 19b).

Petitioner contends that the Court of Appeals erred in excluding from consideration events and circumstances after the merger in deciding that it did not involve a "purchase" by Scurlock.[4] In essence the argument is that anyone who acquires stock in a merger and becomes a statutory insider in the surviving corporation shall be conclusively presumed to have access to insider information useful in timing his subsequent sale of stock which requires that his acquisition of stock in the merger be retroactively treated as a "purchase" within Section 16(b). As the majority opinion observes, this approach misapplies the rule of *Kern County*. The rule applies to only one transaction, the exchange of stock pursuant to a merger. In *Kern County* the question was whether the merger involved a "sale" of Old Kern stock, making it appropriate to examine events between the admitted earlier purchase and the merger to determine whether a possibility for abuse existed. Here the merger was the opening transaction followed by an admitted sale,

[4] It is not clear whether petitioner is arguing that both matters before and matters after the merger up to the time of the sale of shares must be considered or, as the dissent urged, only post-merger matters. If petitioner now embraces the view of the dissent, she cannot consistently also rely (as she does in Point I) on alleged error by the Court of Appeals in its approach to the issue of pre-merger possibility of abuse.

and again the only appropriate inquiry was whether events or circumstances leading up to the merger involved a possibility of speculative abuse requiring treatment of the merger as resulting in a "purchase" within Section 16(b).

The view now urged by petitioner is not only at odds with *Kern County* but would lead to anomalous and unfair results and constitute an extension of Section 16(b) beyond its intended application. It would, as noted, automatically make any person who becomes a statutory insider by reason of a merger automatically subject to Section 16(b) liability should he sell any stock acquired in the merger within six months thereafter. A conclusive presumption would be indulged which would make meaningless the possibility of abuse test which this Court established in *Kern County* as the guide for determining whether an unorthodox transaction constitutes a purchase or sale within Section 16(b). Thus, for example, one not a statutory insider of the disappearing company in a merger whose only connection with the merger was the receipt of more than ten percent of a class of equity stock in the surviving company making him a statutory insider of the surviving company would be liable for any profit realized on a sale of new shares within six months because the merger would be viewed retroactively as involving a "purchase" by him.

Petitioner's argument and the dissent below confuse the limited scope of Section 16(b) with the role played by other provisions of the federal securities laws designed to curb manipulative abuses by insiders. Scurlock's sales were made pursuant to an effective registration statement filed by Susquehanna under the Securities Act of 1933, 15 U.S.C. § 77a. As a director, Scur-

lock in effect warranted that the registration statement did not contain untrue statements of material facts or omit material facts concerning Susquehanna, 15 U.S.C. § 77k(a)(2), and with Susquehanna had a continuing statutory obligation to see that the registration statement included all material information concerning Susquehanna and to update such information if necessary, see I L. Loss, Securities Regulation, 290-293 (2d ed. 1961). Further, Scurlock's sales were subject to Section 10(b) of the 1934 Act, 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (1973), which are designed to prevent abuses of inside information by any person in connection with the purchase or sale of a security and are not dependent on a finding of a matching purchase or sale by an insider within six months before or after the transaction, see *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 278 (S.D.N.Y. 1966), *aff'd in part and rev'd in part on other grounds*, 401 F.2d 833 (2d Cir. 1968), *cert. den.* 394 U.S. 976 (1969), 404 U.S. 1005 (1971), *reh. den.* 404 U.S. 1064 (1972); *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951). Where, as here, no possibility of abuse by Scurlock existed in connection with the merger, he was entitled to have his subsequent transactions in stock of Susquehanna governed by the same rules applicable to others who were Susquehanna insiders. Those who were officers and directors of Susquehanna before the merger and continued as such thereafter could, and in fact did, sell Susquehanna securities within six months of the merger without any question of liability under Section 16(b).[5] Petitioner has estab-

[5] See Official Summary of Security Transactions and Holdings, U. S. Securities and Exchange Commission, for the months of January, February, March, April, May and June, 1968 (Volume 34, Nos. 1-6).

lished no justification for assessing against Scurlock liabilities under Secton 16(b) to which others similarly situated were not subject.

The dissent below finds an anomaly in examining conduct or events before the merger for possibility of abuse by persons who do not become insiders of the surviving company until after the merger. But it is not unreasonable to hold that, if one who becomes an insider had access to information before the merger creating a possibility of speculative abuse in the securities of the surviving company, the merger exchange should be treated as a "purchase" of such securities which will lead to Section 16(b) liability upon their sale at a profit within six months thereafter. The dissent, on the other hand, would ignore everything that occurs up to and at the time of the merger, would conclusively presume that anyone becoming a statutory insider has the opportunity for speculative abuse in timing his conventional sale of shares within six months after the merger (a transaction not subject to the possibility of abuse standard), and would then require an automatic retroactive finding that the earlier merger transaction involved possible speculative abuse and therefore was a "purchase" within Section 16(b).[6] Such approach constitutes, on analysis, nothing less

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[6] *Adler* v. *Klawans*, 267 F.2d 840 (2d Cir. 1959), relied on in the dissent (Pet. App. B 34b-35b) does not support petitioners' position. In imposing Section 16(b) liability upon a defendant who was an insider at the time of sale but not of the prior purchase, the decision deals only with a conventional purchase and sale and does not involve the issue whether an initial unorthodox transaction should be viewed as a "purchase." The decision rests in good part on the fact that Section 16(b) applies to a ten percent beneficial owner only if he is such both at the time of purchase and sale whereas there is no such limitation in the case of officers and directors.

than an abandonment of the possibility of abuse test adopted by this Court in *Kern County*, which requires a decision treating an unorthodox transaction such as a merger as a "purchase" or "sale" to be based on a finding that "the particular type of transaction involved is one that gives rise to speculative abuse." 411 U.S. at 595.

Petitioners argument for a retroactive, automatic finding of possibility of abuse in relation to a prior merger transaction must be rejected as an unwarranted and unfair extension of section 16(b) liability in conflict with the rule of *Kern County*.

III. The decision below presents no important question of federal law warranting review.

Twice within the past three terms the Court has construed Section 16(b). In *Reliance* it applied the section in accordance with its terms to conventional purchase and sale transactions. In *Kern County* it resolved almost 40 years of varying and sometimes conflicting interpretations in the lower federal courts regarding the application of the section to unorthodox transactions such as a merger by requiring a determination on the facts in each case whether an opportunity for speculative abuse is presented to the statutory insider. The two decisions provide ample guidance to lower courts in applying Section 16(b), and this case provides no occasion for the Court to revisit the section.

As noted, the Court of Appeals delayed decision until this Court had decided *Kern County*, and then proceeded with care and discrimination to apply its possibility of abuse standard with differing results among the defendants depending on the facts regarding their relationship to the merger. The decision as to Scur-

lock is in accord with a recent district court decision in another circuit which applied the possibility of abuse test to make Section 16(b) inapplicable to an acquisition of shares in a merger by a director and minority shareholder of the merged company who became a director of the surviving company but was not instrumental in planning or achieving the merger and could not have prevented it although he could have "cashed in" his shares rather than exchange them, see *Morales* v. *Arlen Realty & Development Corp.*, 352 F.Supp. 941 (S.D.N.Y. 1973).

The possibility of abuse test established in *Kern County* was applied by the Court of Appeals in a manner that demonstrates its efficacy as a guide for application of Section 16(b) only to the "particular type of transaction . . . that gives rise to speculative abuse." The decision as to Scurlock provides no reason for this Court to restate or reexamine the possibility of abuse test it has so recently approved.

Respectfully submitted,

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May 30, 1974